PERUMAHAN WIRA SEBERANG SDN BHD

v.

HONG LEONG FINANCE BHD

HIGH COURT MALAYA, PULAU PINANG
ABDUL HAMID MOHAMAD J
[CIVIL SUIT NO: 22-449 OF 1998]
4 MAY 1999

COMPANY LAW: *Charges - Validity - Company charging land to bank for loan - Whether loan constituted a financial assistance to purchase shares in company - Whether loan contravened s. 67 of Companies Act 1965*

The plaintiff was incorporated in 1980 and among its shareholders were Januari Perdana Sdn Bhd and Tham Soon Seong. The plaintiff had sought to develop its land ('the land') into a housing estate, and in 1982 and 1984 it took a loan of RM16.1 million from Bumiputra Merchant bankers Berhad ('BBMB'), upon the security of a charge over the land. In July 1992, Tham Soon Seong acquired some shares in Januari Perdana. Some five years later, in April 1997, the defendant gave a term loan of RM20 million to the plaintiff and also took a charge on the land. The term loan inter alia stated that part of the disbursement was for the purpose of redeeming the outstanding loan from BMBB. Subsequently, the plaintiff defaulted in the payment of interest and the defendant, in consequence, commenced foreclosure proceedings. The plaintiff retorted by seeking a declaration that the charge of the land to the defendant was null and void, on the ground that the loan contravened s. 67 of the Companies Act 1965. The defendant successfully applied to strike out the plaintiff action, whereupon the plaintiff appealed to the judge in chambers.

Held:

[1] The loan documents stipulate that the loan was meant to redeem the plaintiff's outstanding loan from BMBB, as well as to settle preliminary expenses and for working capital of the plaintiff. Clearly, the loan was not given to assist Tham Soon Seong to purchase shares in Januari Perdana or shares of the plaintiff, and did not, therefore, contravene s. 67 of the Companies Act 1965. The facts also showed that the loan was given by the defendant to the plaintiff only in April 1997, whereas the shares of Januari Perdana were acquired by Tham Soon Seong way back in July 1992.

[2] Even if the loan transaction did infringe s. 67 of the Companies Act, the charge is however saved by s. 67(6) thereof. The words "any person" in s. 67(6) is wide enough to cover the defendant bank, such as to allow it to recover the amount of any loan made in contravention of this section. The bank can surely enforce the charge, especially so when it is unaware of the real motive for which the loan was obtained.

[Appeal dismissed.]

Case(s) referred to:
Che Wan Development Sdn Bhd v. Co-operative Central Bank Bhd [1990] 2 MLJ 365 ***(refd)***
Chung Khiaw Bank Ltd v. Hotel Rasa Sayang Bhd & Anor [1990] 1 CLJ 675 ***(refd)***
Co-operative Central Bank Ltd v. Feyen Development Sdn Bhd [1996] 1 SCR 75 ***(refd)***
Wai Hin Tin Mining Co. Ltd v. Lee Chow Beng [1968] 2 MLJ 251 ***(refd)***

Legislation referred to:
Companies Act 1965, ss. 67(1)(6), 133(1), (5)
Companies Ordinance No. 49 of 1940, ss. 47, 48
Contracts Act 1950, s. 24
Rules of the High Court 1980, O. 18 r. 19(1)(b)

For the plaintiff - R Ramanathan; M/s Ram Pillai & Assocs
For the defendant - A Ganasan; M/s Salina, Lim Kim Chuan & Co

Reported by WA Sharif

JUDGMENT

Abdul Hamid Mohamad J:

The plaintiff commenced this action for a declaration that the charge of its land to the defendant is null and void.

On 29 July 1998, the defendant filed a summons in chambers to strike out the writ and the statement of claim under O. 18 r. 19(1)(b) of the Rules of the High Court 1980 (RHC 1980).

On 21 November 1998, the senior assistant registrar allowed the application. The plaintiff appealed to judge in chambers.

On 12 December 1998, I dismissed the appeal. The plaintiff now appeals to the Court of Appeal.

According the plaintiff's statement of claim, the plaintiff was incorporated on 12 July 1980. Its shareholders were as follows:

Shareholders		Percentage
Januari Perdana Sdn. Bhd (formerly known as Doipui Holdings Sdn. Bhd.)	–	73%
Syarikat Berkerjasama Perumahan Angkatan Tentera Malaysia Berhad	–	12%
Tham Soon Seong	–	8%
Aminuddin bin Saad	–	5%
Toh Eng Wah	–	1%
Haslinda Hashim	–	1%

During all the material time, the plaintiff was (and is) the registered owner of the land in question.

On 9 November 1982 and on 20 November 1984, the plaintiff took a loan of RM16.1 million from Bumiputra Merchant Bankers Berhad ("BMBB") to finance the plaintiff's housing project on the said land.

On 15 July 1992, the shareholders **of Januari Perdana** sold their shares **in Januari Perdana** to Tham Soon Seong.

On 4 April 1997, the defendant gave the plaintiff a loan and took a charge on all the said land of the plaintiff. Tham Soon Seong was a guarantor of the said loan.

The plaintiff alleged that the loan was in contravention of the provisions of s. 67 of the Companies Act 1965, because, through the loan, the defendant had assisted Tham Soon Seong to buy shares of the plaintiff through Januari Perdana by charging the whole of the plaintiff's land to the defendant thus enabling Tham Soon Seong to gain control over the plaintiff through Januari Perdana.

In its affidavit in support of the application, the defendant, *inter alia,* said that the purpose of the loan was for the plaintiff to redeem its outstanding loan from BMBB and the remaining was to be utilised as working capital for the development of the housing project on the said land. As security for the loan, the plaintiff took a charge on the said land. Tham Soon Seong as a director of the plaintiff company, guaranteed the repayment of the loan. The plaintiff had defaulted in the payment of interests amounting to RM542,552.68. The defendant had given notice dated 3 December 1997 but the plaintiff still

failed to repay the said amount. By a solicitor's letter dated 17 December 1997 to the plaintiff, the defendant demanded the repayment of the whole loan amounting to RM12,561,998.99 as on 12 December 1997 which the plaintiff to date has not paid.

As a result, the defendant commenced a foreclosure proceedings *vide* Originating Summons No. 24-256-98 in the High Court over two lots, as well as in the Land Office regarding another lot. The defendant says that this action is an attempt to frustrate the foreclosure proceeding.

The following facts are not or cannot be disputed: The plaintiff was incorporated on 21 July 1980. It was/is the registered owner of the land in question which was to be developed as a housing project. Januari Perdana owned 73% of the plaintiff's shares and Tham Soon Seong owned 8%. On 9 November 1982 and 20 November 1984 the plaintiff obtained a loan from BBMB to finance its housing project.

On 15 July 1992, Tham Soon Seong bought **Januari Perdana's** shares from the other shareholders.

Almost five years later, on 4 April 1997, the defendant gave a loan to the plaintiff and took a charge on the plaintiff's land. Tham Soon Seong, as a director of the plaintiff, guaranteed the loan.

According to the defendant's letter dated 10 December 1996 to the plaintiff, confirming the approval of the loan(s), there were two types of loans which the defendant agreed to give to the plaintiff, ie, a Term Loan of RM12,000,00 and an End-Financing Loan of RM20,000,000. Regarding the Term Loan, the purpose of the loan was:

> To redeem an outstanding loan from Bumiputra Merchant Bankers Bhd. amounting up to approximately RM10,000,000.00 and the remaining to be utilised to settle preliminary expenses and working capital.

The purpose of the End-Financing Facility was:

> To Finance the individual end-purchasers of Taman Perwira Phase III comprising 420 units of double storey terrace houses, 8 units double storey semidetached houses and 1 unit of double storey detached house and the future phase comprising of 81 units of 3 storey shop-offices and 200 units of low cost flats on Lots 1244 and 3670, Mk. 14, Seberang Perai Tengah, Penang.

It should be noted that we are now only concerned with the Term Loan.

The annexture to the charge, s. 1.01 states that the term loan of RM12,000,000 was "for the purpose of redeeming an outstanding loan from Bumiputra Merchant Bankers Berhad, the previous chargee, settlement of preliminary expenses and working capital of the borrower and if applicable, to part-finance the construction cost of the project."

Section 3.03 of the same document provides:

> The Facility shall be utilised for the following purposes:
>
> (i) for redeeming an outstanding loan from Bumiputra Merchant Bankers Berhad, the previous Chargee;
>
> (ii) for settlement of preliminary expenses;
>
> (iii) for working capital of the Borrower; and
>
> (iv) where and if applicable, to part finance the construction cost of the Project.

This appeal arises from an application under O. 18 r. 19(1)(b) RHC 1980. I do not think it is necessary to repeat the law. There is really one issue: whether the charge contravenes the provisions of s. 67 of the Companies Act 1965.

That section provides:

> 67(1) Except as is otherwise expressly provided by this Act no company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company or in any way purchase deal in or lend money on its own shares.

That section, in so far as it is relevant to the facts of this case says that no company shall give any financial assistance for the purpose of or in connection with the purchase or subscription made or to be made by any person of or for any shares in the company, **or**, where the company is a subsidiary, in its holding company. The financial assistance may be direct or indirect. It may be by means of a loan, guarantee or the provision of guarantee or otherwise.

A number of cases and an article were referred to this court.

Wai Hin Tin Mining Co. Ltd v. Lee Chow Beng [1968] 2 MLJ 251 is a straight forward case where the plaintiff company lent money to the defendant at the latter's request to enable him to pay for the purchase of shares in the plaintiff company. It was in violation of art. 5 of the plaintiff company's Articles of Association and also clearly in breach of ss. 47 and 48 of the Companies Ordinance No. 49 of 1940. It would also clearly be in breach of s. 67 of the Companies Act 1965.

The next case, in chronological order, is *Che Wan Development Sdn Bhd v. Co-operative Central Bank Bhd* [1990] 2 MLJ 365. In that case, a director of the plaintiff company took a loan from the defendant. The loan was secured by a charge on the plaintiff's land in favour of the defendant. NH Chan J held that the third party charge "was illegal and therefore void and unenforceable by the co-operative Society as it had contravened the prohibition of s. 133 of the Companies Act 1965." Section 133 concerns loan by a company to its directors.

In his judgment, at p. 371, the learned judge said:

> ... I am of the view that s. 133 of the Act (and for that matter s. 67) was passed to protect the company from having its assets depleted through misuse and not only to protect its creditors and shareholders.

Next comes the Supreme Court judgment in *Chung Khiaw Bank Ltd v. Hotel Rasa Sayang Bhd & Anor* [1990] 1 MLJ 357. In that case, by a 1980 agreement the bank granted a loan to the company (Johor Tenggara Sdn Bhd) to facilitate the purchase by the directors of the company of shares in *Hotel Rasa Sayang Bhd* (the hotel). The hotel executed the securities in favour of the defendant. (To avoid complication I do not mention the "1980 loan"). Hashim Yeop A Sani CJ (Malaya), delivering the judgment of the court said at p. 360:

> Looking at the documents, we agree with the learned Judge in this case that the documents here speak for themselves. We also agree that the original loan in 1980 was clearly a contravention of s. 67 of the Companies Act 1965. This was in fact conceded by Mr. Puthucheary for the bank.

The court then went on to consider the effect of the contract which was prohibited by statute.

In this judgment, the learned Chief Justice said at p. 363:

> (a). The object of s. 67 of the Companies Act 1965 is to save the company and no one else

In *Co-operative Central Bank Limited v. Feyen Development Sdn Bhd* [1996] 1 SCR 75 FC the appellant (the bank) granted a loan to a director of the respondent company. As security for the loan, the company created two charges in favour of the bank. On the default of the borrower, the bank instituted charge actions, praying *inter alia* for orders of sale of the charged lands. The company commenced separate proceedings praying for declarations that the charges created were illegal, void an unenforceable for being in contravention of s. 133(1) of the Companies Act 1965. The Federal Court accepted that the charge was in breach of s. 133(1) of the Act but held that

"no civil consequence flowed therefrom, that is to say, no voidness or unenforceability attached to the loan or the charge transactions, regard being had to the content and purpose of s. 133(1), and especially the principle underlying s. 133(5) ..."

It should be noted that the Federal Court disapproved *Che Wan Development Sdn Bhd v. Cooperative Central Bank Bhd* [1990] 2 MLJ 365, regarding the civil consequences of the illegal transaction.

As can be seen all these cases concerned the consequences of the prohibited transaction especially under s. 133 of the Act. I am now concerned with the issue whether the charge is in breach of s. 67 of the Act ie, whether the charge given by the plaintiff to the defendant is a financial assistance to Tham Soon Seong to purchase shares in the plaintiff company or its holding company.

Tham Soon Seong bought shares of Januari Perdana from other shareholders on 15 July 1992. The loan was given by defendant to the plaintiff on 4 April 1997. Tham Soon Seong in his affidavit said that the loan **to the plaintiff**, had assisted him to obtain shares in the plaintiff company through Januari Perdana. How did a loan given **to the plaintiff** 1997 assist him to buy shares in Januari Perdana in 1992, about five years earlier? No answer was given. Furthermore, what was the loan for? I have reproduced the relevant parts of the letter from the defendant to the plaintiff dated 10 December 1996 and the loan documents that clearly say that it was to redeem the outstanding loan from BMBB and to settle preliminary expenses and for working capital of the plaintiff. It was not to assist Tham Soon Seong to buy shares in Januari Perdana, or shares of the plaintiff. Therefore, I am of the view that the transaction is not caught by s. 67 of the Act.

Secondly, it was argued by learned counsel for the defendant that even if the transaction infringed s. 67, the charge was saved by subs. (6) of that section: He relied on *Co-operative Central Bank Limited v. Feyen Development Sdn Bhd* [1996] 1 SCR 75 FC saying that the effect of s. 133(5) on which that case was decided is the same as s. 67(6).

Section 67(6) provides:

> (6) Nothing in this section shall operate to prevent the company or any person from recovering the amount of any loan made in contravention of this section or any amount for which it becomes liable, either on account of any financial assistance given, or under any guarantee entered into or in respect of any security provided, in contravention of this section.

It is to be noted that s. 67(6) is wider than s. 133(5). Section 67(6) allows not only the company but also "any person" to recover "... the amount of any loan made in contravention of this section."

In my view the use of the words "any person" is wide enough to cover the bank (defendant). My reasons are, first, on the authority of *Co-operative Central Bank Limited v. Feyen Development Sdn Bhd* [1996] 1 SCR 75., it is clear that even though a transaction is caught by s. 133 the lender is not prevented from enforcing the charge. That is in spite of the fact that s. 133(5) only speaks of **the company** recovering the loan. Section 67(6) contains words "or any person" in addition to the company, which is wider than s. 133(5).

Secondly, while the object of the section is to save the company, it is also to punish the officer responsible for the illegal transaction. This is especially so where there is a large number of shareholders, the majority of which are not in the know and have no direct say in the day-to-day running of the company. The officers or directors who are entrusted to run the company in the best interest of the company, and consequently, the shareholders, are not expected to abuse that trust and give financial assistance using the funds or assets of the company to someone to purchase share of the company or its holding company. This is against the interest of the company and, eventually, the shareholders. In other words, it is to punish such officers and directors for their wrong doing.

As can be seen from *Co-operative Central Bank Limited v. Feyen Development Sdn Bhd* [1996] 1 SCR 75 even when the transaction, contravenes s. 133 (or s. 67, in my view) the bank (lender) is still not prohibited from enforcing the charge. This is only fair, especially where the bank is innocent or unaware of the real motive for which the loan was obtained. Of course, if the charge cannot be enforced, the company will get a windfall and the shareholders will also benefit, more so in a small family company. But is it fair to assume that Parliament in making the law, intended to enrich a company and its shareholders by dubious and dishonest means? I do not think so.

True that morality is not law. But public morality has always been an ingredient in the formulation of common law. Even the Contracts Act 1950, s. 24 provides:

> 24. The consideration or object of an agreement is lawful, unless -
>
> ...
>
> (d) the court recards it as immoral, or opposed to public policy.

So, whereas morality as such is not law, it is a factor that the court should not purposely disregard in the interpretation of a law. If a law is open to two interpretations, one leads to an unjust, unfair and immoral result and the other leads to the opposite, the latter should be preferred.

Anyway, I do not have to go that far. On the authority of *Co-operative Central Bank Limited v. Feyen Development Sdn Bhd* [1996] 1 SCR 75, I am of the view that the charge, even if caught by s. 67(1) (which I do not think so) is saved by subs. (6).

For these reasons I dismissed the appeal with costs.